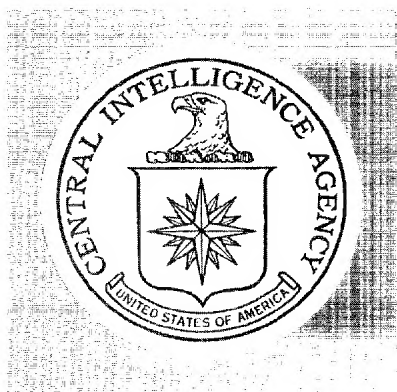


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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

South Vietnam: Current Developments in the Economy

State Dept. review completed

Secret

ER IM 68-97
August 1968

Copy No.

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
August 1968

INTELLIGENCE MEMORANDUM

South Vietnam:
Current Developments in the Economy

Summary

The widespread physical damage and disruptions resulting from the Tet and May-June offensives in South Vietnam have led to an economic recession in the urban areas and a decline in rural incomes. In urban areas the recession stems from a widespread undermining of both business and consumer confidence. It has occurred despite increased government expenditures for reconstruction and mobilization which, together with lagging revenues, have increased the money supply. Fearing for their personal safety and the security of their material possessions, urban residents have refrained from all but the most necessary spending. The result has been: (a) a decline in retail sales of manufactured consumer goods, (b) a near absence of new private capital investment, (c) a drawdown in inventories, (d) a slowdown in imports except of basic foods, (e) a lack of recovery of industrial production, and (f) near price stability in the face of a rapidly rising money supply.

In rural areas, real incomes have declined mainly because greater insecurity has increased the difficulty and cost of transporting foods to Saigon and manufactures from Saigon. The volume of rice deliveries from the Delta to Saigon has declined

Note: This memorandum was produced solely by CIA. It was prepared by the Office of Economic Research and was coordinated with the Office of National Estimates, the Office of Current Intelligence, and the Director's Special Assistant for Vietnamese Affairs.

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despite higher rice output. There also has been a sharp drop in prices received by farmers for their products coupled with a sharp increase in the prices they must pay for manufactured goods.

If security and confidence are not restored, the prospects are for continued economic stagnation in urban areas and the failure of plans to raise agricultural productivity and real incomes. The basic needs of the urban population would continue to be satisfied by government imports, and depressed activity in the private sector would facilitate military mobilization. If security improves and confidence grows, business and consumer spending will accelerate. Since the growth of imports and production would probably lag well behind the growth of demand, rapid inflation could be expected. Moreover, the recovery of economic activity at a time of mobilization would lead to greater pressures on the labor market, and inflation would be fed by rising wages.

Inflation can be minimized by monetary reforms and government actions, such as a war risk insurance scheme, to hasten the recovery of production and increase imports. It appears that the government will rely most heavily on increased imports to stem inflation. Rural incomes will improve if transport security improves and/or retail prices of rice are raised in Saigon.

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The Stabilization Effort

Developments During 1965-67

1. Strong inflationary pressures have persisted in the war-torn Vietnamese economy since mid-1965, but the joint United States/Government of Vietnam (US/GVN) stabilization effort has succeeded in keeping them within tolerable limits. Saigon prices,* which increased 62 percent between June 1965 and June 1966, leveled off after an initial rise following the mid-June 1966 devaluation and rose only 4 percent during the last five months of 1966. As a result of the June devaluation and related stabilization measures, GVN revenues rose 64 percent during 1966. The black market rate for dollars and gold declined from predevaluation heights, indicating increased confidence in the piaster, and the rapid growth in the money supply was curbed.

2. Accelerated military and civilian spending coupled with declining domestic output caused inflationary pressures to pick up again in 1967. Nevertheless, the 34-percent rise in prices during 1967 was well below the 68-percent increase for 1966. The money supply increased only 26 percent in 1967, compared with increases of 37 percent and 74 percent in 1966 and 1965, respectively. The success of the 1967 stabilization effort was due in large measure to a dramatic increase in imports. Absorption of money via imports in 1967 was particularly effective because the June 1966 devaluation had increased the exchange rate from 60 piasters per US \$1 to 118 piasters per US \$1 and imports were available on an almost unrestricted basis.

The Situation Prior to the Tet Offensive

3. As 1967 drew to a close it appeared that the inflationary process was under control and that 1968 would be a year of transition during which the economic gains so painfully achieved since mid-1966 would serve as a springboard for further advances in

* *NIS Consumer Price Index (without rent) for the working class in Saigon.*

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economic stability, output, and productivity. Current indications, however, are that during 1968 resources will be stretched extremely thin. Shortages of skilled labor will be widespread and monetary pressures will intensify. Although the Viet Cong winter-spring campaign and the heavy fighting in the cities during the Tet and May-June offensives contributed heavily to present economic problems, a careful examination of monetary data for the months immediately preceding the Tet offensive shows that an inflationary trend had already been under way. Monetary data show a 19-percent increase in the money supply during 1 November 1967 - 31 January 1968 (equivalent to an annual rate of more than 100 percent), compared with an increase of only 17 percent during the 10 months January-October 1967. Price movements lagged behind this spurt in the money supply, with the consumer price index showing a gain of only 3 percent from 1 November 1967 through the end of January 1968. Viewed on a weekly basis, however, prices began to increase steadily during January, and, although this upward trend partially reflected seasonal pre-Tet buying, it appears that money-supply-fed inflation had resumed.

Price Trends Since the Tet Offensive

4. This trend was interrupted by the Tet offensive, which set in motion a series of deflationary forces sufficient to offset continued large increases in the money supply. These forces still persist. An analysis of price movements during the first half of 1968 is illustrative. When the Tet offensive was launched on 31 January, markets were closed for the holidays, and, because households were stocked for the festivities, the shock of the fighting on consumers was cushioned. Subsequently, when consumers ventured forth and found markets still closed and most items scarce, prices soared, reaching a peak on 12 February of 70 percent above the level at the beginning of the year. This peak was followed by an almost uninterrupted decline during the next seven weeks as supply conditions in Saigon and elsewhere gradually improved. By the beginning of April, prices were only 5 percent above those at the beginning of the year. This price decline cannot be interpreted, however, as a return to normal supply and demand conditions. In fact, supplies of many goods

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remained lower than before the Tet offensive, and prices fell only because consumer demand was greatly reduced.

5. During April, food prices began to rise again because of the continued interdiction of traffic on Route 4 from the Delta and precautionary buying by consumers in anticipation of renewed attacks. Although prices of some locally manufactured nonfood items increased as production failed to return to pre-Tet levels, nonfood prices as a whole rose only 4 percent compared with a 10-percent increase in food prices. Moreover, two items -- calico and cigarettes -- accounted for all of the nonfood increase. The prices of all other nonfood items included in the sample either declined or held steady during the month. Prices of selected imports showed a gain of less than one percent. The renewed enemy attacks launched on 5 May caused further interruptions in the flow of goods and a renewed increase in the general price level -- up 14 percent between 29 April and 3 June. As the accompanying chart shows, higher food prices once again accounted for most of this increase. Prices of nonfood items and imported goods were relatively steady. Since 3 June, prices of both food and nonfood items have declined almost without interruption, and prices of imported goods generally are unchanged.

Factors Affecting Prices

6. Inflation has not been severe since the Tet offensive because of a decline in business and consumer demand. The entire private urban sector of the economy has been depressed. This depression reflects a loss of confidence: fear of losses from war damage and personal physical security and general uncertainty about the future. Businessmen are trying to reduce inventories and achieve liquidity. Fixed investment has nearly ceased. Only a few foreign firms -- whose risks are insured by their home governments -- have announced expansion plans. Import activity is greatly reduced as importers adopt a wait-and-see attitude. Similarly, consumers are cutting expenditures and holding cash. The relative stability of black market currency and gold prices during the past six months indicates that for the time being at least, most people are content to hold their cash balances in the form of piasters. Demand

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for Hondas, sewing machines, and other formerly fast-moving luxury items has fallen off sharply. In early July the price of imported transistor radios was 10 percent below that at the beginning of the year, while the price of motorcycles was 12 percent lower. Moreover, no one has much desire to acquire real estate.

7. The strength of these deflationary forces has been sufficient to offset much of the substantial new monetary creation. The money supply has continued to expand steadily since the end of 1967, registering a 32-percent increase during the first five months of 1968 compared with a 5-percent rise during the comparable period of 1967. During the first quarter of 1968, almost all of this increase was accounted for by a growth in circulating currency; demand deposits increased only slightly, as shown by the following tabulation:

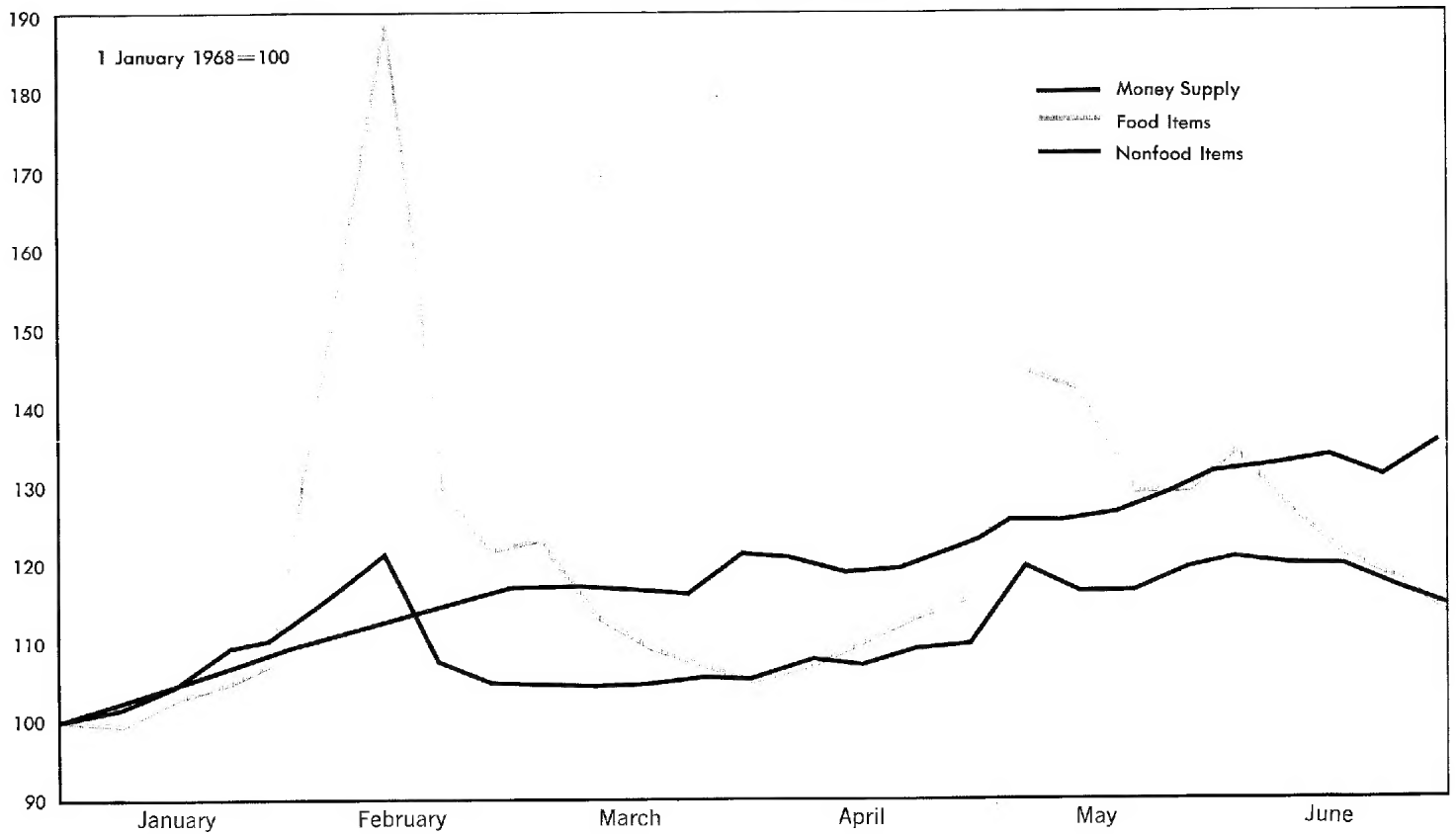
	Billion Piasters ^{a/}		
	<u>Total</u>	<u>Notes in Circulation</u>	<u>Private Demand Deposits</u>
November 1967	80.1	60.6	19.5
December 1967	82.6	62.1	20.5
January 1968	90.7	69.7	21.0
February 1968	96.5	75.3	21.2
March 1968	100.3	78.9	21.4
April 1968	101.7	N.A.	N.A.
May 1968	108.9	N.A.	N.A.

a. As of the end of each month.

While there has been no run on the banks, the people have continued to express a preference for cash in hand since the February offensive. As was the case prior to Tet, the deficit of the public sector continues to account for most of the increase in the money supply (see Table 1). Increased expenditures, primarily for mobilization and reconstruction -- at a time when tax receipts were held down by the slowdown in imports, retail sales, and industrial output -- are the chief factors behind the public sector monetary expansion.

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SOUTH VIETNAM
INDEXES OF WEEKLY MONEY SUPPLY AND SAIGON RETAIL PRICES
JANUARY-JUNE 1968



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Loans and advances to the private sector have contributed almost nothing to the growth of money supply.

Table 1

South Vietnam: Net Money Supply
November 1967 - March 1968 a/

	Billion Piasters				
	1967		1968		
	Nov	Dec	Jan	Feb	Mar
<u>Creative factors</u>					
International assets	21.2	21.4	22.1	23.2	23.3
Financing of government	70.0	73.5	79.5	83.4	88.1
Financing of business	27.3	26.8	27.1	28.4	27.9
<i>Total creative factors</i>	<i>118.5</i>	<i>121.7</i>	<i>128.7</i>	<i>135.0</i>	<i>139.3</i>
<u>Neutralizing factors</u>					
Quasi-money	9.3	10.0	10.4	9.9	9.3
Government deposits	10.7	12.9	10.0	8.9	11.9
US aid deposits	9.6	7.1	8.5	9.7	7.7
Deposits of US sector	0	0	2.6	2.2	2.6
Other items (net)	8.8	9.1	6.5	7.8	7.5
<i>Total neutralizing factors</i>	<i>38.4</i>	<i>39.1</i>	<i>38.0</i>	<i>38.5</i>	<i>39.0</i>
Net monetary creation	<u>80.1</u>	<u>82.6</u>	<u>90.7</u>	<u>96.5</u>	<u>100.3</u>

a. As of the end of each month.

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Nonagricultural Economic Activity Since the Tet
Offensive

8. Saigon and several other South Vietnamese cities suffered considerable physical damage and disruption during the Tet and May-June offensives. Some industrial plants were destroyed and others damaged; inventories were lost as a result of the attacks and from looting; transport, communications, and trade were disrupted; housing losses were heavy; and thousands became unemployed. The physical effects of the offensive, however, were far less serious and widespread than the psychological effects, which resulted in a prolonged crisis of confidence that has created an economic recession.

9. Most industrial facilities are located in the Saigon area, which until February 1968 had been almost untouched by the fighting. In 1967, industrial production increased by an estimated 12 percent, or very close to the average annual rate of increase since 1962. The only major branch of industry to register a decline in output was textiles, which faced heavy competition from imports. It was expected that overall output would continue to rise during 1968 at about the same rate as in the past, with textile production beginning to recover as a result of import restrictions. During the Tet offensive, however, about one-third of the Vietnamese textile mills, including the two largest (which account for about 40 percent of total textile output), were demolished or severely damaged. A total of 84 industrial and commercial establishments were destroyed or damaged. The cost of rebuilding and repairing or replacing machinery, equipment, and inventories is estimated at about \$58 million, or one-third of the cost of all physical damage resulting from the Tet offensive. As a result, industrial production during the first quarter of 1968 was below that of the corresponding period of 1967. Output of beer, ice, and oxygen was off by 20 to 30 percent, while cotton yarn and fabric registered declines of 57 and 68 percent, respectively. Production of cement fell 61 percent and glass output declined 56 percent.

10. Five months after the Tet offensive, there was little evidence that the business community was making serious plans to rebuild. Clean-up operations

were under way at most of the damaged firms, but many of their employees still had not been rehired. Undamaged textile plants were not increasing output despite the fact that half of their domestic competitors were either slowed down or put out of business. It is reported that this cautious attitude was even more apparent in areas outside Saigon, particularly among the people whose business is marketing and transporting goods throughout the countryside.

11. Importers -- many of whom are industrialists importing for their own use -- also have adopted a cautious attitude. New orders were already low before the Tet offensive because of the high level of inventories and have fallen off sharply since then except for necessities such as foodstuffs, pharmaceuticals, building materials, and petroleum products. Some importers have stated that they are trying to sell to wholesalers at cost in order to achieve some degree of liquidity. This watch-and-wait attitude has persisted not only because of the continuing insecurity which has reduced consumer demand but also because the government has been slow to help businessmen get back on their feet. Not until 27 April did the government announce the establishment of a reconstruction loan fund, and a program for war risk insurance was not approved by the National Assembly until July. The reconstruction loan fund, with initial capital of \$8.5 million, will be supplemented by a \$10 million grant from the United States to provide loans for importing replacements for US-manufactured machinery and equipment destroyed or damaged during the Tet offensive.

12. These funds, however, provide only part of the impetus necessary to restore business and confidence. Probably very few firms will be willing to rebuild without some assurance that they would be indemnified against future loss. Nor will all importers be willing to place substantial new orders without some form of insurance for goods in storage or in transit. In the past, truckers and barge operators have been able to get a kind of insurance by paying off the Viet Cong, but since the Tet offensive the latter have begun deliberate mining of civilian vehicles, especially in the Delta, where commercial activity is greatest. The government has

been forced to organize convoys of trucks and barges in order to move goods in and out of Saigon. It seems clear, therefore, that some kind of insurance plan is essential to clear the atmosphere of uncertainty, which more than anything else has retarded the return to normalcy. An insurance bill covering risks of war damage was passed by the National Assembly on 10 July, but insurance probably will not be available to the business community before September. Moreover, coverage will be limited to losses up to 500 million piasters (\$4.2 million) and to those firms that the government considers essential to the economy and will not include loss of life. Until the provisions for implementation are announced, it will not be known what kinds of acts of war are covered, and it is possible that losses from terrorism or sabotage will not be insurable.

The Rural Economy

Agricultural Output

13. Until the Tet offensive the prospects for the agricultural economy during 1968 were relatively encouraging. After a three-year decline, the 1968 rice crop* was expected to be slightly above that of 1967, and both US and Vietnamese officials were planning to begin a program to increase rice production dramatically during the next four years. The relatively steady improvement in the life of many rural Vietnamese during the last two years was expected to continue as prices for farm products in urban markets remained high and agricultural inputs and consumer goods were distributed more widely in the countryside. The Tet offensive and ensuing developments have changed this outlook considerably. Indeed, it now seems probable that, although output of rice increased this year, production of most other agricultural products will be lower, and real income and consumption will decline in much of rural Vietnam.

* Data on rice output are for the crop year, which ends on 31 May of the year designated.

14. Rice production was not directly affected by the Communist attacks during the Tet offensive. Most of the rice harvest, particularly in the Delta (IV Corps), which accounts for more than two-thirds of the crop, was completed before the Tet offensive, and agricultural officials report an increase of 8 percent above the 1967 crop (see Table 2).

Table 2

South Vietnam: Production, Imports,
and Deliveries of Milled Rice
1964-68

Thousand Metric Tons			
Year	Production <u>a/</u>	Imports <u>b/</u>	Delta Deliveries to Saigon <u>b/</u>
1964	3,196	0	505
1965	3,111	130	449
1966	2,893	434	321
1967	2,602	750	282
1968	2,813	725 <u>c/</u>	300 <u>c/</u>

a. Crop year.
b. Calendar year.
c. Estimated.

Almost all of the increase resulted from higher output in IV Corps, particularly in the provinces where the 1967 crop suffered heavy flood damage. A survey team which toured the Delta in mid-April reported that the surplus available for deliveries to Saigon could total more than 300,000 tons* in 1968 compared with 282,000 tons in 1967 if price incentives and sufficient transportation were available. During the first six months of 1968, however, deliveries totaled only 116,000 tons, compared with 161,000 tons during the same period of 1967. In order to stimulate the rice trade the government purchased 40,000 tons of rice in April from Delta merchants at a price above the going market level.

* Tonnages are given in metric tons.

15. This purchase apparently was too small, however, to have the desired effect. In mid-July, therefore, the GVN decided to purchase another 60,000 tons of rice from Delta merchants and, once this rice is shipped to Saigon, to announce a guaranteed support price which will be maintained indefinitely. By these measures officials hope to draw about 200,000 tons of rice from the Delta during the second half of 1968. Of course, in addition to providing price incentives to farmers, the GVN will have to ensure at least the present degree of security on supply routes from the Delta.

16. The continuing uncertainty about the size of Delta deliveries, which in normal times satisfy most of the rice requirements of Saigon and the urban areas in the northern part of the country, has made it difficult to estimate how much imported rice will be needed in 1968. In view of the increase in production this year, officials currently are estimating import requirements at about 725,000 tons compared with 750,000 tons delivered during 1967. If the government's purchase and price measures are not successful, however, in drawing more rice out of the Delta, it is possible that somewhat larger imports will be necessary. More than 90 percent of Vietnamese rice imports will come from the United States, either via the Food for Freedom (PL-480) program or through purchases by the GVN with its own foreign exchange.

17. Losses of livestock during the Tet offensive were heavy, especially in the Delta. These losses, caused mainly by the inability to transport live animals to the Saigon markets, were estimated at about \$18 million, or roughly 10 percent of the cost of repairing all physical damage throughout the country caused by the Tet offensive. Dinh Tuong Province, which has one of the largest livestock populations in the country, was hardest hit, losing one-third of its hogs and about 10 percent of its chickens and ducks. Vietnam's fresh water fishing operations also suffered from the offensive as a result of heavy damage to seven hatcheries. US officials' most optimistic estimate is that fresh water fish production this year will only equal that of 1967.

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18. Production of most other important agricultural products probably will continue to decline. Data for 1967 show that, of the major agricultural products, only the output of green vegetables and tobacco increased (see Table 3). The high demand for vegetables by urban Vietnamese and US forces presents truck farmers with such an inviting market that many rice farmers have shifted either partly or entirely into vegetable production. Vegetables and tobacco have a higher rate of return than rice and can be grown on small plots of land with comparative ease and security.

Table 3

South Vietnam:
Production of Selected Agricultural Products
1965-67

	<u>Thousand Metric Tons</u>		
	<u>1965</u>	<u>1966</u>	<u>1967</u>
Vegetables	133	143	192
Manioc	236	280	262
Sugar cane	1,093	936	770
Fruits	441	379	359
Peanuts	33	34	34
Tea	6	5	4
Tobacco	8	7	8
Rubber	65	49	43

Other Aspects of the Rural Economy

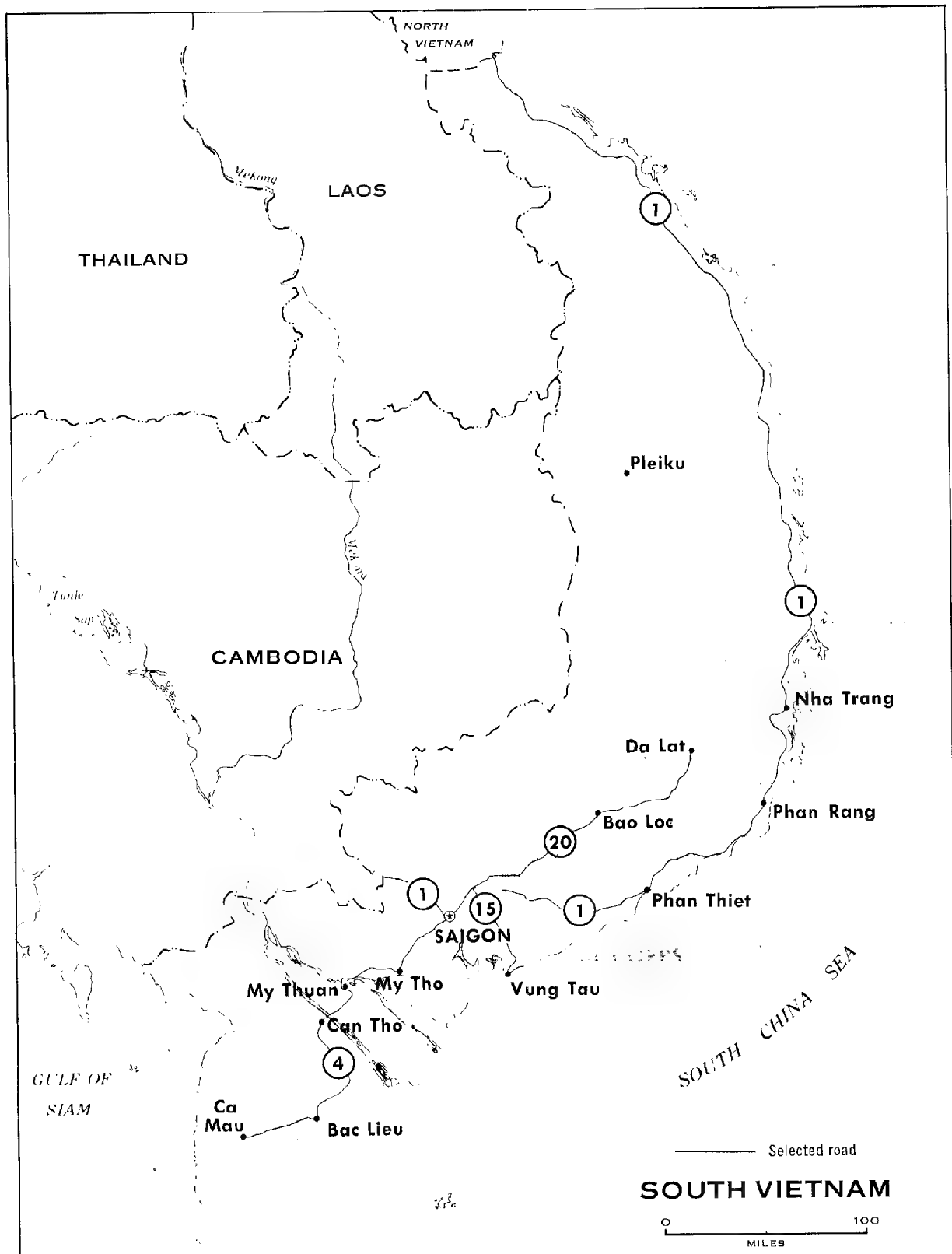
19. Although most agricultural output was not immediately affected by the offensive, the attacks have had widespread repercussions on the rural economy. Peasants depend heavily for their livelihood on the activities of merchants and tradesmen in the towns and on the transportation routes linking rural areas with urban markets. The Tet attacks abruptly reduced the security of the roads and waterways and undermined the confidence of tradespeople. Because the security status of most roads throughout the country is changing constantly and reporting on these conditions is erratic, it is impossible to make a meaningful assessment of the entire transportation system.

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Nevertheless, it is clear that the transportation system is less secure than it was prior to the Tet offensive. Government convoys of trucks and barges, inaugurated after the Tet attacks, still are required to move goods between the Delta and Saigon as well as in other parts of the country. Little is known about security on the secondary roads, but most reportedly are receiving no maintenance and are deteriorating.

20. It is possible, however, to make some general assessment of conditions on the four national roads that are the most crucial to economic activity. Civilian traffic on the major commercial road in Vietnam -- Route 4 from Saigon south to Ca Mau in An Xuyen Province (see the map) -- revived slowly after the Tet offensive and still is not moving as freely or as heavily as in January. Since the Tet offensive the road has become a prime Viet Cong target, and allied military forces have had to conduct frequent clearing operations to keep it open. As a result, most of the rice moving to Saigon from the Delta is being carried by barge convoys, whereas during 1967 most rice was carried by truck via Route 4. Route 20 south from Da Lat apparently has not been an enemy target and thus has been open throughout almost all of the post-Tet period. This road, the second most important in terms of Saigon's food supply, connects the capital with the center of Vietnam's largest vegetable-producing area. Route 15 from Vung Tau also has remained open with only minor disruption since Tet. Since February the importance of Route 15 has increased because the closing of roads from Rach Gia in Kien Giang Province resulted in the movement of the larger fishing boats to Vung Tau, making that city a more important source of Saigon's fish supply. Unlike the other major roads, Route 1, which runs from the Cambodian border through Saigon and up the coast to the DMZ, has not been open along its entire length for several years. Interdiction and closures still are frequent, and most areas in I and II Corps continue to rely on the movement of goods by coastal vessels from Saigon and direct arrivals of imported goods at the ports of Cam Ranh, Nha Trang, Qui Nhon, and Da Nang.

21. The loss of security on the roads and waterways and in the towns during the Tet attacks resulted



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in a drastic reduction in economic activity throughout the countryside. With the waning of the offensive and the restoration of some degree of normalcy, urban market prices declined dramatically, and by 1 April retail prices in Saigon were actually slightly below the level prevailing before the Tet offensive. It appears that prices paid to farmers for perishable items such as hogs, poultry, vegetables, and fruit had for the most part also returned to pre-Tet levels by the beginning of April. Yet the price of rice -- the most important farm product -- still is depressed. As of the end of June the price paid to the farmer for paddy (unmilled rice) in the Delta ranged from 9 to 11 piasters per kilogram, compared with 12 to 15 piasters a year ago. The offensive itself and the insecurity since February have made merchants reluctant to push ahead with the normal post-harvest purchasing activity.

22. Because of the risks involved, transportation costs doubled after the Tet offensive and have remained high. Probably most discouraging to the rice trade is the fact that, because of ample supplies of imported rice, retail prices of rice in Saigon have remained relatively stable near the pre-Tet level. At the end of June, government stocks of imported rice in Saigon totaled 156,000 tons, or two months' supply of imported rice for Saigon and the northern rice-deficit provinces. Retail prices have not been high enough to tempt many merchants to risk their lives and property in order to resume deliveries to Saigon. As noted earlier, the government recently decided upon new purchase and price support measures in order to get rice moving into Saigon and raise farmers' income. It is too early to judge the effects of these measures, but US officials in Saigon consider them workable. In the past, however, government intervention in the rice market frequently has been bungled, and the current program will place tremendous strain on the government's administrative capabilities.

23. Some of the same factors that are keeping the price of paddy low in the rural areas also are pushing up the prices of goods from Saigon purchased by the farmers. Fewer trucks are traveling the roads, and the drivers who take the risk are charging much higher fees. This situation is particularly

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true in the Delta and III Corps, which account for two-thirds of the population, where the Viet Cong are making a concerted effort to interdict lines of communication. Prices of goods such as kerosene, fertilizer, canned milk, and consumer durables, all of which must be brought in from Saigon, reportedly are 15 to 25 percent higher than before the Tet offensive. Government truck and barge convoys are moving some goods in both directions, but these convoys are inadequate substitutes for the volume of commercial traffic that moved prior to the Tet attacks.

24. In brief, the terms of trade have turned sharply against the rural populace: most farmers currently are receiving less for their rice while paying more for nonfarm products. During 1967 the average price that farmers received for paddy rose 75 percent. Allowing for the increase in the cost of living, the purchasing power of farmers' cash income from rice still was about 18 percent above that in 1966, and there probably was a substantial, although smaller, increase in total farm income. During the first half of 1968, farmers' cash earnings from rice sales were below those of the same period in 1967, and farm incomes from other agricultural products also were lower. Since income from the sale of rice and other agricultural crops and from the performance of farm-based activities, such as milling of rice and vending of produce, probably accounts for roughly 75 percent of total farm money income, however, it is clear that the decline in total farm money income has been substantial. With the 15- to 25-percent increase in prices paid by farmers, moreover, the purchasing power of farm incomes is certainly far below the level of a year ago.

Manpower

Mobilization

25. During the period from June 1965 through the end of 1966 the labor situation in South Vietnam was extremely tight, largely as a result of the US military construction program. Although this situation improved during 1967 and there currently is no general manpower shortage, there continues to be a shortage

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of skilled labor as evidenced by the large number of third-country nationals (primarily from Korea and the Philippines) still employed in South Vietnam. Whether the government's recent mobilization measures tighten the labor market again depends heavily on whether the current recession continues. Shortages of technical skills cannot be relieved by the large number of refugees or the persons temporarily unemployed because of the Tet and May-June offensives. Moreover, only in the US sector of the economy can these positions be filled by third-country nationals, and even the use of such workers in this sector is a politically sensitive issue in Vietnam.

26. Population and labor force data are inadequate to permit any detailed analysis of the effects of the mobilization measures on the various sectors of the economy and the activities of government agencies, but all reports indicate that the economy could be affected adversely. To date, the most damaging measures have been the callup of reserves with less than five years' active duty and the elimination of almost all deferments, both of which actions were part of the speedup in mobilization ordered by President Thieu in February. Many employers had purposely chosen veterans for critical positions in order to avoid losing essential personnel to the draft. The government originally had set the callup date for 15 March with no provision for deferments. The hardships caused by this policy were immediately apparent, however, and the government postponed the date at least a month and set up some interim procedures for decisions on deferments. Several government agencies, such as the Directorate of Civil Aviation and the Saigon metropolitan water office, were about to shut down certain of their facilities when they received last-minute deferments for some of their most essential personnel.

27. The manpower drain will be aggravated further by the implementation of the 19 June general mobilization bill, which expands the draft age and provides for the recall of veterans with less than 12 years' service. This bill provides that deferments for a limited period may be granted to police, Revolutionary Development cadre, technical specialists, and teachers who temporarily have no replacements as well as public

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health and education cadre serving in the countryside, but it is not yet clear how this provision will be implemented. Short-term deferments will not provide much relief to employers in the private sector, where as much as one-fifth of currently employed manpower could be called up. The effect of the mobilization bill on government services in the provinces, where two-thirds of the civil servants are located, could be especially serious. The Ministry of Agriculture, for example, has estimated that 600 of its employees could be drafted or recalled, and the Ministry of Education expects to lose possibly 50 percent of the country's secondary school teachers and 20 percent of the elementary teachers. By the end of May, Phu Bon Province in II Corps already had lost its information and finance service chiefs and was due to lose four more service chiefs in the future. In addition, the Ministry of Health recently was ordered by presidential decree not to replace persons entering military service, and it is possible that this order will be extended to all other ministries.

Internal Migration

28. The manpower situation in Vietnam also has been adversely affected by the internal migration of thousands of people, either by choice or as refugees. As the mainstay of the economy, agriculture has suffered most from this mass dislocation and migration of people. According to official estimates of the labor force, the agricultural sector lost more than 1.5 million workers between 1960 and 1966. During the same period the nonagricultural labor force roughly doubled, increasing its share of the total civilian labor force from 12 to 28 percent. Most of this movement probably has taken place since 1965, when the tempo of the fighting picked up with the increased commitment of US forces. During 1965-66, about 1.5 million persons registered with the government as refugees.

29. Moreover, the buildup of US forces meant a rapid growth of nonfarm economic opportunities for both skilled and unskilled labor. The opportunities in construction, transportation, and other services as well as the persistent insecurity in rural areas generated a large migration to urban areas. During

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1967, this movement to urban areas continued, and, in addition, another 400,000 persons entered the ranks of refugees. Of the roughly 2 million persons officially counted as refugees during 1965-67, about 40 percent still were considered refugees at the end of 1967, while 30 percent had been resettled and the remaining 30 percent had returned to their original villages.

30. The concentrated fighting this year in urban areas has generated refugees at a much faster rate but so far has produced no measurable exodus of people out of the cities. During the high point of the Tet offensive, almost 900,000 persons registered as refugees throughout the country, and another 180,000 registered in the Saigon area during the May-June offensive. By the end of June, many of these people were no longer on the refugee rolls, having returned to their homes, resettled in government housing projects, or received money, cement, and roofing in order to rebuild. Yet on 28 June 1968 the government still was faced with the problems of feeding, housing, and trying to resettle almost 10 percent of the population, as shown in the following tabulation of refugees:

	<u>Thousand Persons</u>
Regular	1,133
Tet	192
Post-Tet	170
<i>Total</i>	<i>1,495</i>

31. Except for agriculture, this large number of refugees probably has little impact on the labor market. Most of the Tet and post-Tet refugees are located in urban areas, and many undoubtedly are continuing to work despite the loss of their homes. Studies on the so-called regular refugees -- those not identified with the Tet or May-June offensives -- indicate that many refugees who had been employed before their migration still were employed, although the majority had been forced to change occupations. These studies show that the percentage of unemployment among refugees varies considerably by area of

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the country. During 1967, for example, unemployment among the refugee labor force in Phu Yen rose from 1 to 33 percent after migration but from 1 to only 9 percent in Dinh Tuong Province. The impact of the refugee population on the labor force is further minimized by its age/sex composition. According to an early 1967 survey of 22,094 heads of refugee families representing 113,067 persons taken in 59 refugee centers through South Vietnam, the refugee population was composed mainly of children and, probably, more females than males. The survey showed that children of both sexes up to 15 years of age totaled almost half of the sample population, with males outnumbering females in this group. Beyond 15, however, females were in the majority in every age grouping.

Outlook

32. The Communist offensives during the first half of 1968 have greatly changed the economic situation in South Vietnam and have made the economic outlook highly uncertain. A great deal depends on whether military and political developments bring about a revival of confidence among the urban population. It is now estimated that during 1968 the money supply will increase by about 50 billion piasters, or roughly 60 percent, compared with 26 percent in 1967 and an original 1968 estimate of 24 percent. Such a large monetary overhang poses an obvious threat of renewed inflation. But if the enemy continues or intensifies the offensive in the Saigon area, business confidence will not be restored and the economic depression will continue. In such a case, incomes and the supply of domestic and imported goods in the cities would decline and the urban population would for the first time begin to experience some degree of austerity. Military mobilization, however, would be facilitated as depressed activity in the private sector of the economy resulted in reduced demand for manpower.

33. Deteriorating security conditions also will mean the failure of plans to raise agricultural productivity and rural real incomes. Late in 1967, US and GVN officials adopted a plan to make Vietnam a self-sufficient rice producer again by late 1971.

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Such a goal would require about a 50-percent increase in production in only four years, relying mainly on the use of the new, more productive IR-8 and IR-5 rice seeds developed in the Philippines. The program probably was too ambitious under the conditions existing in late 1967; it looks even less realistic now. The maximum benefit from the use of the new seeds requires a massive reeducation of farmers and depends upon a far greater use of fertilizer, pesticides, and water control than now prevails. Continuing insecurity will make it difficult for US and GVN technicians to provide the services that must accompany the use of the seed. Moreover, the necessary inputs require large cash expenditures by farmers, but the low paddy prices of the last five months plus losses of other crops and livestock mean that farmers will have less money to spend and less incentive to seek credit for these expenditures. There reportedly still is considerable interest on the part of both peasants and local officials in the IR-8 program, but the 110,000 acres scheduled to be planted with IR-8 this year already have been cut back to about 92,500 acres, and it is doubtful that even this goal will be achieved.

34. Increased insecurity and the concomitant failure of the government's new rice program would mean an additional decline in real income for farmers as rice prices remain low and transportation costs for goods procured from urban areas remain high. The decline in real incomes will be most severe in III and IV Corps, where farmers depend heavily on Saigon as their primary market and major source of agricultural inputs and consumer goods. The peasants in I and II Corps, which are not surplus-producing areas, undoubtedly will continue to be poorer than their southern counterparts, especially if commercial traffic on the major roads in the northern half of the country remains at low levels. Nevertheless, it is unlikely that there will be any food shortages in I and II Corps, which contain four major ports through which additional food and other necessities can be moved.

35. If, on the other hand, security and a normal business atmosphere are restored, rapid inflation is likely because of the growth of the quantity of money in the hands of the population and a probable lag in

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the growth of imports and production. The labor shortages expected to result from increased mobilization will further feed the inflationary process.

36. Faced with growing requirements for reconstruction and mobilization, the GVN is being forced to increase its expenditures. Accordingly, it has been attempting to cut purchasing power by increasing taxes. An increase in tax rates on imports was enacted by decree on 1 April, and a 20-percent surcharge on most domestic taxes was signed into law on 4 July. In addition, plans have been made to increase POL taxes in the near future. Although collections of revenues during the first five months of 1968 were somewhat higher than during the same period of last year, it seems unlikely that total tax revenues during 1968 will exceed last year's collections. Collections of domestic revenues so far this year have been higher, primarily because of higher income tax collection. But the increase in income tax receipts is a nonrecurring one. It almost certainly reflects the withholding of income tax by US private contractors and US government civilian and military agencies, which did not commence until July 1967. The taxes withheld from current income were paid in addition to those based on the previous year's income. There is no reason to believe that revenues from income taxes during the remainder of 1968 will be above those of July-December 1967, when withholding was in effect, and they could be lower in view of the adverse effects of the offensives on income. Customs revenues, which account for 30 percent of national revenues, also will decline because imports during the remainder of 1968 will be below the 1967 level. Revenues both from customs and from taxes on domestic production and sales will rise as these activities pick up, but it is likely that they will rise less rapidly than demand. The seriousness of the inflation that will result from a recovery of economic activity will depend, of course, on the timing of the economic reversal. In order to allow time for an orderly response of imports and production to increased demand, a gradual restoration of security and business confidence would be best.

37. There are other measures that the GVN could take to minimize inflation. Tax collections could be improved, but this is a difficult process which

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is unlikely to bring in much revenue soon. The most effective way of getting rid of the excess money in circulation would be to call in all currency and issue new plaster notes with limitations on the amount of new currency issued to any one individual. Such a reform, however, would encounter strong political opposition and might further undermine public confidence. Another method of stemming inflation would be to provide attractive interest rates -- exceeding or adjusted for the rate of price inflation -- in order to increase savings. This reform, which has long been urged by US advisers, has met with no encouraging response from the GVN.

38. Action could also be taken to minimize the lag in the adjustment of the supply of goods to growing demand. Imports probably are the most important way of absorbing the new inflationary pressure, and the GVN has ample foreign exchange reserves with which to finance imports. Although it takes two to three months to order and receive imports from nearby sources and much longer from the United States and Europe, measures could be taken to speed up the process by eliminating much of the red tape involved in the granting of import licenses. Moreover, the government could ensure that ample credit and war risk insurance are available to importers.

39. The decline in the standard of living in rural areas will be halted if security, particularly on the roads, improves and merchants are able to insure themselves against losses. Improved transportation combined with a government program to guarantee a high price of rice would be a boon to farmers. An increase in the retail price of rice in Saigon probably would add to wage pressure in the cities, especially if the current recession were ended, but the urban consumers have borne none of the increased costs of marketing rice since the Tet offensive. Rice prices in Saigon still are at the pre-Tet level, while paddy prices are well below that level.

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